



Providing Global Development Solution

**MICROFINANCE SUPPORT PROJECT**

PROGRESS REPORT  
AS OF JUNE 30, 2002

Submitted to USAID/Honduras

Submitted by CARANA Corporation

Under Subcontract to Barents Group LLC

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## **I. EXECUTIVE SUMMARY**

### **1. Introduction**

Technical assistance and training activities during the first semester of this year focused almost exclusively on consolidating the gains made in previous periods. As programmed in the fifteen-month work plan submitted in January, assistance to FPVOs focused on only a few areas:

- The transformation process from an NGO to a fully regulated FPVO under the new law;
- Implementing pilot programs and/or the rollout of new simplified credit procedures and forms in all of the key FPVOs;
- Design and/or Implementation of loan officer incentive systems that reinforce each FPVO's objectives;
- Strengthening of the internal audit and control function;
- Assistance with client desertion / client loyalty issues.

### **2. FPVO Level Assistance**

During the semester, major gains were made in the implementation of the recommendations made in previous periods. For example:

- All of the principal FPVOs have made substantial progress in implementing our recommendations in the different areas where we have provided assistance.
  - All have successfully carried out pilot projects in the field in at least one area (simplification of credit procedures and forms), and in some cases have also implemented pilots in other areas (incentive systems, internal audit and controls, marketing, etc.).
  - All have made the decision to, or are actually implementing a rollout of recommendations that have been successfully tested in a pilot phase.
- All five institutions have made the commitment to convert to a fully regulated FPVO as soon as possible and all have made substantial progress towards this goal.
- FINCA has successfully completed its stabilization plan and its new management is now implementing plans to regain market share. CARANA's assistance, first in reviewing and improving their credit methodology, and later in strengthening their internal audit and control function, has played a major part in their recovery process.
- After much urging on our part, World Relief has begun to make some important progress in the implementation of our recommendations in the credit area. Assistance

in other areas (marketing - client loyalty issues, and organizational analysis) has also been received favorably and management has indicated that they will be moving forward with the implementation of those recommendations as well.

- Managers at Covelos retail unit have aggressively implemented our recommendations in the credit area and are also moving decisively to implement additional recommendations in the human resources area. Their success was evident in the dramatic improvement in most of their financial indicators as of December 2001.
- Hermandad de Honduras has also aggressively implemented our recommendations in credit and marketing, and has shown a remarkable commitment in their decision to reorganize and prepare for eventual supervision under the new law governing FPVOs in Honduras.
- A decision by ODEF to implement the decentralization of the credit process is viewed as a major breakthrough by the CARANA team, as this is the final step in the process of streamlining their credit operations. In support of this process, CARANA has successfully leveraged USAID project funds with those of the Spanish government (CODESPA - Foundation of the Royal Spanish Government) to assist in the implementation of our recommendations. This is the second time that CARANA has been able to leverage project funds with outside sources.

### 3. Other Project Activities

Work carried out in previous periods was either finished or completed ahead of schedule.

- DataCrédito Centroamericana S.A. de C.V. became fully operational during the first semester of this year - almost a year ahead of schedule. CARANA staff is no longer providing any additional support for this activity. Total investment in this activity was minimal (less than \$10,000) making this one of the most cost effective interventions under the project.<sup>1</sup>
- The reorganization of the Covelos Foundation into three distinct legal entities is progressing according to the work plan that we assisted in developing in 2001. CARANA provides only minimal support for this process at this time.
- CARANA's role in helping the public sector in the implementation of the new law governing FPVOs concluded with the delivery of the draft audit and supervision manuals in 2001. However, given the significant delays this year in the implementation of this law within the public sector, CARANA has recently begun to provide limited support to the superintendency of banking in order to assist the process. CARANA's current level of support is limited due to budgetary constraints.

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<sup>1</sup> When compared the cost of USAID's support in the creation of a credit bureau in other countries, USAID's investment in Honduras to create a fully functioning credit bureau in the private sector has been negligible.

#### 4. Impact Analysis and Client Surveys

During the second semester of 2001, the CARANA team conducted two training sessions with selected FPVOs introducing the AIMS-SEEP Impact tools developed under a project in USAID Washington. The first of these workshops was carried out in July of 2001, and focused on the Client Desertion tool (survey methodology). The second workshop was carried out in December, and it also consisted of a one-week training program on another of the AIMS-SEEP tools - Client Satisfaction.

As reported earlier, the level of commitment by the FPVOs has been extraordinary. With over a thousand interviews conducted by the respective FPVOs using these survey tools, the FPVOs have been able to gather a tremendous amount of information on the marketplace in which they work and on their own loan products and services within these markets. Much of this information was used by our consultants during the first semester of 2002 to work with the management of several FPVOs in the design and implementation of programs to specifically address the issues raised in the surveys carried out by these FPVOs.

While the surveys themselves have not addressed the impact of the credit programs on the clients, some of the surveys have gathered preliminary information on the use of the credits by the clients, and on the impact that these credits have had on their businesses and households. For example, the surveys conducted by FINCA revealed the following information that while the majority of the respondents recognized that the loans had helped them in their business, the loans had also had an important impact on their lives:

- Almost 90% of the respondents said that the loans had had a positive effect on their personal lives:
  - 35% said that they were able to have more and/or better food
  - 22% said that they had more resources for a family member's education
  - 22% also said that they had additional funds for clothing and more or improved items for their houses.

While it is not possible to draw any conclusions on the overall impact of microfinance loans in Honduras, the high level of impact measured in this sample clearly indicates that microfinance lending in Honduras is having an impact on the lives of the poorer segments of Honduran society.

#### 5. Progress Against Project Indicators

- An analysis of the key indicators by financial institution as of December 2001 was provided to USAID in June of 2002. As indicated in the memorandum document submitted to USAID, the results were mixed and varied by institution with Covelo's retail operations showing the most positive results of all five reported institutions.
- Actual results against technical assistance indicators (implementation of pilot programs and rollout of these programs after pilot testing) established for the semester were very

positive, showing that the project was either meeting or exceeding the indicators established for June 30, 2002.

- All major activity indicators were completed ahead of schedule, with the exception that no FPVO is currently operating under the supervision of the banking superintendency. This is due to delays in the public sector, which are outside of the control of the project.

#### 6. Analysis of the Work Plan vs. the Activities Undertaken During the Semester

- Almost all of the technical assistance activities programmed for the eighteen-month period from January 2002 to March 2003 were completed by June of 2002 as planned. Of the remaining five short-term technical assistance interventions (not including continued assistance to the FPVOs in the transformation to a regulated institution which is ongoing), three were in progress by the end of July, and the other two will be completed in the period from September to November 2002.

#### 7. Financial Data

- Based on our preliminary data as of June 30, 2002, we have incurred total expenditures of \$1,727,000 in labor and expenses out of a total budget of \$2,347,575, or 74% of the project's total budget. With respect to total level of effort, we have utilized a total of 2,110 days out of a total of 3,059 days, or 69% of the total.
- As indicated in our semester report dated December 31, 2002, CARANA will submit a no cost budget modification in order to modify the budget along line items. We expect to do this in August or September.

#### 8. Key Issues Facing the Project at This Time

The project is not facing any major issues or threats at this time. We are pleased to report that we are either achieving or exceeding all of our targets, and our relationship with the project beneficiaries remains very positive. However, as pointed out in our last semester report, there are four major activities currently not addressed under the project that we believe should be addressed by USAID in the future. These were:

- Training and support to the National Banking Commission on the implementation of the new law governing the FPVOs in Honduras;
- The need to develop a better MIS solution for FPVOs in Honduras;
- Additional assistance to Tier III and other FPVOs in Honduras that are not currently beneficiaries under the current project;
- Follow-up assistance to the Covelco reorganization.

While we continue to believe that all four areas are important, two of them are critical to the long-term success of the microfinance initiative in Honduras: assistance in the implementation of the new law and the need to develop a better MIS solution in Honduras. It is also our understanding that these two issues were also deemed critical by the evaluation team that completed an evaluation of the project in July 2002.

## **II. PROGRESS REPORT AS OF JUNE 30, 2002**

### **A. TECHNICAL ASSISTANCE AND TRAINING ACTIVITIES**

#### **1. Introduction**

Technical assistance and training activities during the first semester of 2002 focused almost exclusively on consolidating the assistance provided to selected FPVOs during the previous two years. Assistance centered around providing assistance in the transformation to a fully regulated FPVO, consolidating gains and implementing pilot programs and the rollout of new simplified credit procedures and forms, strengthening of the internal audit function, and assistance with client desertion / client loyalty issues.

During the semester, all but five short-term technical assistance interventions programmed in the fifteen-month work plan for the period from January 1, 2002 to March 31, 2003 were completed. Of the remaining short-term technical assistance interventions, three were in process in July of 2002, and the remaining two interventions would be completed in the period from September through November. The remaining interventions are in addition to the ongoing technical assistance to FPVOs supporting their transition to fully regulated FPVOs, of which at least three or four more follow-up visits per institution are planned in the remaining nine months.

#### **2. Technical Assistance and Training to FINCA Honduras**

Assistance to FINCA focused primarily on issues related to the transformation to a regulated FPVO, and support in strengthening the internal audit function. During the semester, CARANA staff also carried out an analysis of client desertion based on the exit surveys conducted by FINCA as a result of the Impact Analysis work carried out with all the FPVOs in 2001. A brief discussion of each of these activities is presented below.

##### **a. Assistance in transformation to a regulated FPVO**

In February, Mr. Phelps met with FINCA's new management team to discuss issues regarding the planned conversion to a regulated FPVO. This was the first meeting with FINCA's new management on this topic, and as a result, our consultant focused primarily on presenting the new legal / regulatory framework and its implications on the organization and getting a better understanding of the level of technical assistance that FINCA was likely to require in this area. FINCA's management agreed to work on the identification and analysis of relevant issues and to consult with their Board of Directors regarding the appointment of a working committee focused on the FPVO transition process.

In March, Mr. Phelps held a follow-up meeting with FINCA's management on the same subject, which consisted of a two-day work session in addition to individual meetings with managers and board members of FINCA to assist them in refining their plans for achieving FPVO status. Specific timetables were developed stressing that planning and preparation should be integrated as part of each organization's strategic planning efforts for 2003 and

beyond. The consultant also worked with other CARANA consultants providing technical assistance to FINCA to ensure that CARANA recommendations for organizational, procedural and methodological improvements are implemented as an integral part of the evolution of this FPVO. The March meeting was followed up by another meeting with FINCA's management in June, however, Mr. Phelps found that they had progressed little on the subject in the two months since the previous meeting. As a result, Mr. Phelps focussed on providing additional guidance and a specific list of activities to be carried out before the next meeting.

b. Support in strengthening the internal audit function

During the month of April, CARANA consultant, Mr. Mario Miranda, initiated a four-week technical assistance activity, which focused on an analysis of the internal auditing function and on the development of specific recommendations to improve the internal audit function. The work emphasized the weaknesses in the current internal audit function and provided procedures and recommendations for the internal audit function as FINCA moves to become a regulated institution. An English translation of the executive summary of this report is provided in Annex C of this report.

c. Analysis of client desertion

The planning, supervision, and analysis of the exit surveys conducted by FINCA staff as a result of the training program carried out with all of the major FPVOs in 2001 was carried out by CARANA Chief of Party, José Luis Lozano and CARANA intern, Cara Westermann. A total of 198 interviews were conducted with clients who had left the FINCA program, and the analysis carried out on these interviews highlighted some important data on why these clients had left the FINCA program, their satisfaction with the program, and the probability that they would return at some future date. The English translation of the executive summary of this report is provided in Annex D of this report.

### 3. Technical Assistance and Training to World Relief Honduras

Technical assistance was provided to World Relief of Honduras across a variety of fronts, including the simplification of credit procedures and formats, assistance in marketing, assistance in Human Resources, and assistance in the transformation to a regulated FPVO. Highlights of each are discussed below.

a. Simplification of credit procedures

This is part of an ongoing effort being overseen by CARANA resident, Mr. Elvis Alva. This initiative focuses on the simplification of credit procedures, which includes assistance in the decentralization of the decision-making process, assistance with the rollout of the revised credit evaluation forms throughout the institution, and assistance in developing written procedures for the use of the new forms as well as a guide for the revised credit procedures. These proposals have all been accepted by management, and they are now being implemented throughout World Relief.

b. Assistance in marketing

In February of 2002 CARANA consultant, Mr. Luis Ludeñas, carried out a four week technical assistance activity with World Relief in the marketing area. The consultant focused on an analysis of client desertion issues and some of the major trends behind the desertion of clients. Based on the analysis, the consultant provided management with specific recommendations designed to improve client loyalty and stability. CARANA resident advisor, Mr. Elvis Alva, has been providing follow-up support to this activity in the implementation of some of the recommendations made by Mr. Ludeñas. An English translation of the executive summary of this assignment is presented in Annex E of this report.

c. Assistance in transformation to a regulated FPVO

In February 2002, CARANA consultant, Mr. William Phelps, conducted a follow-up working session with the management of World Relief, which was then followed by a planning session with members of the Board and management. At the planning session, members analyzed issues regarding the conversion to a regulated institution, discussed options and procedures, and approved an action plan and a specific calendar for proceeding with the process of transition to a regulated FPVO.

In March 2002, Mr. Phelps held two-day work sessions and specific meetings with World Relief managers and board members to assist them in refining their plans and advance preparations for achieving FPVO status. Specific timetables were developed stressing that planning and preparation should be integrated as part of each organization's strategic planning efforts for 2003 and beyond. Mr. Phelps followed up the March meetings with an additional set of meetings in June to measure progress in the transformation process and provide additional guidance on the subject.

d. Human resources and organizational issues

During the semester, CARANA resident Mr. Elvis Alva, completed an analysis of World Relief's organizational structure vis-à-vis the new law governing the FPVOs in Honduras. A revised organizational structure was prepared and presented to the Board of Directors for their approval. The revised structure separates many of the day-to-day operations from the administration and reporting functions within the organization. Approval by the Board of Directors is currently pending.

In May, CARANA consultant Celestino Padilla, began a consulting assignment to assist management in the preparation of job descriptions and specifications under the new organizational structure, as well as a position and salary manual for the institution. This assignment is expected to be completed by August of 2002.

4. Technical Assistance and Training to Covelo's Retail Credit Operations

CARANA resident advisor Mr. Elvis Alva is actively involved in the implementation of the technical assistance activities being carried out at Covelo, which center on the

simplification of the credit procedures and assistance in the human resources area. Additional (although very limited) assistance was also provided at the "holding company" level in the reorganization process as a follow-up to the work completed in 2001.

a. Simplification of the credit procedure and related activities

During the semester, a pilot program using the new formats for credit evaluations was successfully carried out and preparations were made for the rollout across the institution. Mr. Alva also designed a new client evaluation worksheet for Covelo (under review by Covelo's management), and participated in the effort to improve the presentation materials used with new clients as part of the orientation process.

Mr. Alva also developed a formal training program in support of the credit area within the institution, which consists of five different training programs. The first of these - Credit Evaluation - was carried out on the 21<sup>st</sup> and 22<sup>nd</sup> of March. A second course - the administration of a branch office and the supervision of a credit portfolio was undertaken in July. Additional courses to be implemented in the second semester of 2002 include Internal Controls, Client Service and Work Groups.

b. Human resources

During the first semester of 2002, Mr. Alva also assisted management in the implementation of a new incentive program for loan officers, which is based on eight variables that support Covelo's overall objectives. During the semester, Mr. Alva also developed a manual for the use of the new incentive program as well as a spreadsheet tool for comparing the results of the new incentive program vs. those achieved by loan officers under the previous incentive program using real data for the period from December to February 2002.

In May 2002, CARANA consultant Mario Miranda carried out a four-week technical assistance intervention at Covelo, which centered on the design of a process and the preparation of a manual for the evaluation of the job performance of the managerial, administrative and operations personnel of the Foundation. This assignment was completed successfully and was also supported by Mr. Elvis Alva. It is important to note that this activity was not in the action plan for this period, but was added at Covelo's request and with USAID's approval. An English translation of the executive summary of this report is provided in Annex F of this report.

5. Technical Assistance and Training to Hermandad de Honduras

Technical assistance to Hermandad de Honduras during the semester focused on strengthening the credit procedures, marketing, and assistance in transformation to a regulated institution. A summary of the activities undertaken in each of these areas is presented below.

a. Credit procedures

Assistance in this area was carried out by Mr. Elvis Alva, and focused primarily on the work carried out in 2001 with Hermandad de Honduras. During the semester Mr. Alva supported the implementation of the simplified credit forms and also prepared an operations manual for working with these forms. Mr. Alva supported the implementation of the revised credit analysis procedures and also prepared a manual detailing the credit evaluation process. Both of these initiatives were emphasized in a formal two-day training program carried out in May with Hermandad's staff (Credit Evaluation and Capacity to Pay). The program has been very successful and is currently pending Board approval for formal adoption by the institution.

b. Assistance in marketing

In April, CARANA Consultant Luis Ludeñas carried out a three-week technical assistance intervention at Hermandad, which centered on an analysis of the client surveys that had been completed by Hermandad in 2001 under the AIMS-SEEP training program (134 surveys). These surveys focused on client desertion and client satisfaction issues. After completing the analysis, the consultant then worked with management to develop specific recommendations to improve client desertion and client loyalty. Mr. Elvis Alva has been working with Hermandad to support the implementation of these recommendations. An English translation of the executive summary of Mr. Ludeñas report is provided in Annex G of this report.

c. Assistance in the transformation to a regulated institution

In March, Mr. Phelps held a two-day working session and specific meetings with Hermandad managers and board members to assist them in refining their plans for achieving FPVO status. This intervention was followed by a call to management in June to discuss the transformation process and provide additional guidance.

In May, Hermandad's management provided the CARANA team with a proposed reorganization for Hermandad in response to the transformation process. Their proposal was based on our recommendations, and is currently pending approval by the Board of Directors.

6. Technical Assistance and Training to ODEF (*Organización de Desarrollo Femenino*)

Technical assistance activities for ODEF centered around three major areas: Continued support in credit methodology, assistance in human resources management, and assistance in the decentralization of the credit process.

a. Assistance in credit methodology

During the semester, CARANA resident Elvis Alva continued to support ODEF in improving the credit methodology within the institution. Specifically, Mr. Alva worked on

training loan officers in analyzing a client's capacity to borrow and repay a loan and on credit analysis in general. Work in this area included the analysis of the individual, the family unit, and the micro business.

b. Human resources - implementation of an incentive system for loan officers

CARANA consultant Elvis Alva also worked with ODEF's management in the definition and implementation of an incentive system for loan officers. Working with management, specific variables were selected and an incentive system was designed, along with a draft procedures manual for implementing the system. The incentive system has been tested with data for the first three months of the year and some modifications were made at management's request. The final system is now pending management's approval for implementation in the second semester of 2002.

c. Assistance in the decentralization of the credit process

In June, CARANA Consultant Henry Cardona began working with ODEF's management on the decentralization of ODEF's credit operations. Mr. Cardona reviewed the work prepared by ODEF for this purpose and made additional recommendations for improving the process. After reviewing his findings with management, Mr. Cardona then drew up plans for a trial operation through a pilot program. The pilot addresses the revised credit procedures, internal control procedures, as well as changes in administrative and financial systems to support the decentralization process. Upon completion of this assignment at the end of June, Mr. Cardona began work on the implementation of the pilot program for two months with funding from CODESPA (Foundation of the Royal Spanish Government), which was coordinated with CARANA's help. An English translation of the executive summary of Mr. Ludeñas report is provided in Annex H of this report.

## 7. Technical Assistance and Training to FAMA

Technical assistance to FAMA was limited to two areas: assistance in the transformation to a regulated FPVO and assistance in marketing (client loyalty and branch analysis).

a. Assistance in transformation to a regulated FPVO

In February of 2002, CARANA consultant, Mr. William Phelps, held a follow-up working session with the management of FAMA. This working session was followed by a planning session with members of the Board and management discussing options and a course of action for the conversion to a regulated FPVO.

The February planning meetings were followed in March by a two-day working session and meetings with specific managers and board members FAMA to assist them in refining their plans for achieving FPVO status, and a timetable was developed for the transformation process. Mr. Phelps followed up with managers in June to discuss the transformation process and provide additional guidance.

b. Assistance in marketing

In February, CARANA consultant Henry Cardona carried out a three-week technical assistance intervention at FAMA. The consultant focused on client desertion issues and made specific recommendations on how to collect and analyze client information in order to have a better understanding of the reasons leading to client desertions. The consultant carried out a limited survey on his own and in conjunction with a review of credit procedures, made recommendations in credit procedures and policies to address some of the problems that he identified. The consultant also worked with management in carrying out an analysis of the Danli branch which has produced marginal results and which is being considered for closing. The English translation of the executive summary of this report is provided in Annex I of this report.

8. Technical Assistance and Training to FUNED

Technical assistance to FUNED was limited to a four week consulting assignment in February / March by CARANA consultant Mario Miranda on client loyalty and desertion issues. The consultant's work was based on the preliminary diagnostic work completed by CARANA's chief of party, José Luis Lozano. The evaluation focused on issues affecting the growth and quality of FUNED's loan portfolio, particularly client desertion. Based on a survey of clients and an evaluation of their market, Mr. Miranda recommended several programs that management could use to improve client loyalty, reduce desertion and stimulate client referrals. The English translation of the executive summary of this report is provided in Annex J of this report.

9. Institutional Strengthening and Training Efforts with Selected FPVOs in Honduras

During the semester, CARANA consultant William Phelps made three trips to Honduras to continue his work in assisting selected FPVO managers and their respective Boards of Directors in the development of strategies and specific work plans to prepare for the eventual transition to a fully regulated institution under the country's newly passed law governing micro finance services. (The law requires compliance by micro financial NGOs with specific terms and conditions by March 2003.) The objectives of the meetings and telephone conferences included:

- Reviewing NGO progress with implementation of work plans established during earlier consultant visits;
- Strategic planning sessions with management and the Boards of Directors;
- Adjusting work plans, as necessary;
- Advancing development of NGO bylaws and other documents needed to comply with the OPDF law (being coordinated with Covelo);
- Coordinating CARANA provided and other technical assistance initiatives with the FPVO transformation process and;
- Integrating individual strategic planning at each institution with the FPVO transformation and compliance process.

While the individual interventions are highlighted in the previous sections, a summary of where each of the principal FPVOs are in the transformation process is presented below.

a. World Relief of Honduras

World Relief is in a relatively advanced state of transition. CARANA has been working closely with select members of the board of directors and management to develop a clear understanding of the law and its implications, and integrate the process of its transition into the organization's strategic planning activities. Particular attention has been given to coordinating CARANA's other technical assistance to World Relief with the preparations for the transformation to a regulated FPVO.

During the subject consultancy:

- A task force of key managers was established to assume leadership of the transition process, including assignment of specific responsibilities and completion dates;
- The task force developed criteria for cleansing the various loan portfolios in anticipation of transfer to a new legal entity, and the portfolio cleansing process was initiated;
- The development of recommendations regarding the structure of the new entity for presentation to the general assembly was advanced and;
- Legal documentation for the new legal entity was advanced.

b. FINCA

FINCA has advanced the development of the new constitution (*estatutos*) for a new legal entity to comply with the new law and initiated the process of organizational analysis, but considerable additional work with their management and board of directors is necessary. In a memorandum prepared in June to FINCA's management, CARANA made specific recommendations to FINCA for the organization and acceleration of the transition process, legal structuring for the new legal entity and other issues considered essential to efficient evolution to a fully regulated FPVO.

c. Hermandad de Honduras

Hermandad de Honduras' management reports that they are following the work plan that was developed in conjunction with CARANA technical assistance for development of a new legal entity to comply with the transformation process. Hermandad has begun the process of portfolio cleansing and has advanced development of legal documentation and organizational restructuring according to plans. Its management is also adapting many of the methodological and other reforms recommended by CARANA advisors, as part of their transition process.

d. Organización de Desarrollo Femenino

ODEF has developed three work committees consisting of management and board members to address legal and organizational issues relative to its transition to a regulated

FPVO. The committee structure was developed with the assistance of CARANA consultants. ODEF is expected to convert their current organization to a fully regulated FPVO and expects to be ready to present the related proposals to their General Assembly in July or August, according to the schedule developed with them.

e. Covelo

Covelo is well into their transition to three separate organizations: (1) COVELO Foundation, (2) a wholesale lending FPVO and (3) a retail lending FPVO. General Assemblies and Boards of Directors have been organized for each of the three entities, and organizational / operational division has begun. COVELO expects its new structure to be fully operational by January 1, 2003. Many functional aspects of the new organizational structure have been recently operationalized on a "pilot" basis.

10. Support to the Diploma in Microfinance Program

As part of our ongoing support to Covelo and the University of Honduras in the implementation of a joint program to offer a Diploma in Microfinance, CARANA consultant, Henry Cardona, delivered a twenty-hour course between February 21 and 23 on credit methodology. Twenty participants from eight different institutions attended the program, which included individual and group exercises, and which was also supplemented with written handouts on the subject for participants to use as reference material in their own work.

**B. OTHER PROJECT ACTIVITIES**

Other project activities consist of the credit bureau activity and support to the legal and regulatory environment. CARANA's participation in both of these tasks has been successfully completed, although continued support to the legal and regulatory environment remains a high priority.

1. Credit Bureau Activities

DataCrédito Centroamericana S.A. de C.V. became fully operational in the first semester of 2002 - almost a year ahead of schedule. CARANA staff are no longer providing any formal support to DataCrédito (nor was any programmed), and we are very pleased to bring our activities in this area under the project to a successful close.

2. Legal and Regulatory Environment

CARANA's support to the government in this area was limited to the preparation of two manuals required under the law governing the FPVOs in Honduras, and this work was completed in 2001. No additional work in this area was budgeted for 2002 and 2003.

Unfortunately, with the change in government, staff turnover at the Banking Superintendency has meant that some time had to be invested by our consultants in 2002 bringing the new staff up to speed on what was done under the previous administration

and what still needs to be done in order to comply with the requirements of the law by March 2003, the date on which it is supposed to take effect.

While progress in the public sector came to a virtual halt in the first semester, CARANA has continued to work with the individual FPVOs to prepare them for the eventual transformation or conversion to a regulated FPVO (see Section II.A.9. of this report). This work has gone very well, and the FPVOs are committed to making the necessary changes in order to comply with the new legislation, recognizing that it is also helping to strengthen their own institutions. Unfortunately, with the lack of progress in the public sector, many of the FPVOs are now reluctant to continue working on the transformation process given that there are still many undefined issues that the government still has to address.

Support to the public sector in helping them to successfully prepare for and implement the supervision of FPVOs in Honduras is essential. This is a complex process that requires full time attention, which is currently outside the scope of the CARANA microfinance project. However, if not supported properly, this legislation could result in a cumbersome and overly bureaucratic supervision process that will stifle rather than encourage microfinance efforts in Honduras.

Regardless of when additional support can be arranged to the public sector, it does not appear that the government will be prepared to operationalize the current legislation by March of 2003 as is currently envisioned. At this time we believe that a delay of at least nine months would be prudent, and would give both parties (the FPVOs and the Banking Superintendency) additional time with which to prepare for eventual supervision of the FPVO sector.

## **C. PROGRESS AGAINST PROJECT INDICATORS**

### **1. Progress Indicators**

Progress indicators are reported on every semester and are used to monitor activity within the different components of the project. These include the types and numbers of T/A interventions, training sessions, and other activities established in the work plan for the period. A discussion of this is provided in Section D - Analysis of the Work Plan vs. the Activities Undertaken.

### **2. Key Indicators by Financial Institution**

Key indicators by financial institution are made up of eight specific financial or quantitative indicators established for each of the five key FPVOs with which CARANA works. These indicators were selected to measure Quality, Outreach, and Efficiency. Specific targets were established for each of the key FPVOs for December 31, 2001 and December 31, 2002, and reporting on these indicators was to be completed annually. A separate report on these indicators as of December 31, 2001 was provided to USAID on July 2, 2002. The next report on these indicators will be due in 2003, once the FPVOs have closed their accounting for the fiscal year and have provided the information to Covelo for processing.

### 3. Technical Assistance Indicators

Technical assistance indicators were an attempt to measure progress among the FPVOs in the implementation of CARANA's recommendations. These were defined by the decision by each FPVO to adopt our recommendations in a pilot program (Pilot Program) and the decision by an FPVO to implement the program throughout the whole institution (Rollout). These indicators were established for every semester of the project and are reported on in each semester report.

As of June 30, 2002, all five of the principal FPVOs have successfully adopted and carried out pilot programs in at least one major area (simplification of credit procedures and forms) and in some cases have implemented pilot programs in other areas (new incentive systems for loan officers, promotional campaigns addressing client loyalty and desertion issues). This achievement compares favorably to our overall target of having at least five institutions implementing pilot programs by June of 2002.

As of this date, all five of the key FPVOs have also made the decision to and/or are actually implementing a rollout of our recommendations that have been previously tested on a pilot basis and modified as required. This also compares favorably against a target of at least 4 institutions having made the decision to implement a rollout of our recommendations by June 2002.

### 4. Major Activity Indicators

These indicators were developed by establishing specific benchmarks for other major project activities that were not FPVO specific or that affected the operating environment within which the FPVOs operate in Honduras.<sup>2</sup> These indicators were also established for every semester of the project and are reported on in this section of the report.

#### a. The new law governing the FPVOs

As reported in section II.B.b of this report, there have been some significant delays on the part of the government in the implementation of the new law governing FPVOs in Honduras. As a result, the results under this activity are mixed. One of the indicators for this activity - decision by an FPVO to operate under the law - has been overtaken by the fact that the banking superintendency has interpreted that every FPVO will be subject to regulation under the new law. However, we are pleased to report that all five of the principal FPVOs, along with several of the smaller ones, have taken this process seriously and are all working to meet the transformation deadline of March 2003 (even though we anticipate that the government will not be able to comply with its requirements under the

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<sup>2</sup> Originally, only two major activity indicators were proposed: Assistance in implementing the new law governing FPVOs in Honduras; and, Support in establishing a credit bureau in Honduras. In late 2000, a third initiative was added to support the separation of functions and the restructuring process within the Covelo Foundation. This third activity was successfully completed in November of 2001.

law by that date). This compares favorably with the target of five institutions having made the decision to operate under the law by June 2002.

The second target that had been established in this area called for two of the FPVOs to be operating under the law by June 2002. Unfortunately, given the delays experienced in the government, this target is not valid at this time. CARANA does continue to provide technical assistance to the FPVOs in this area in preparation for when the government is prepared to begin the supervision process.

b. Support in establishing a credit bureau in Honduras

As reported in section II.B.a, this activity has been completed almost a year ahead of schedule. Perhaps more importantly, the total investment under our project in supporting this activity was minimal (less than \$10,000), making this one of the most cost effective interventions under the project.

#### **D. ANALYSIS OF THE WORK PLAN VS THE ACTIVITIES UNDERTAKEN**

1. Technical Assistance to Tier I and Tier II FPVOs

The activities carried out in this semester closely follow the work plan for the eighteen months from January 2002 to March 2003 submitted during the previous semester report.

As can be appreciated in the analysis below, almost all of the technical assistance activities programmed for the eighteen-month period have been completed or have been initiated as of July 2002. We expect all of the short-term technical assistance activities to be completed by December of 2002, three months before the end of the project.

a. World Relief

Four major activities were programmed for World Relief in the eighteen-month work plan through March 2003 in addition to the ongoing support provided by our resident advisors. These are:

i. Assistance in the transformation to a regulated FPVO

This activity is being carried out by Mr. William Phelps. It is an ongoing process and is progressing as scheduled.

ii. Marketing analysis - client loyalty and desertion issues

This assignment was completed in February by CARANA consultant Luis Ludeñas.

iii. Assistance in Human Resources administration

This work was initiated in May with Mr. Celestino Padilla and is scheduled to be completed in August.

iv. Assistance in strengthening the internal audit function

This assignment was initiated in July, by Mr. Mario Miranda, and will be completed by August.

In addition to the above, our resident advisor, Mr. Elvis Alva has provided follow-up and support on the above activities, and continues to work with the institution on strengthening the overall credit process.

b. FINCA

Three major activities were programmed with FINCA in the eighteen-month work plan through March 2003 in addition to the ongoing support provided by our resident advisors. These are:

i. Assistance in the transformation to a regulated FPVO

This activity is being carried out by Mr. William Phelps. It is an ongoing process and is progressing as scheduled.

ii. Assistance in strengthening the internal audit function

The work in this area was carried out successfully in April by CARANA consultant Mario Miranda.

iii. Marketing analysis - client loyalty and desertion issues

Although originally scheduled to be completed using short-term technical assistance, this work was completed by CARANA resident chief of party, José Luis Lozano and intern Cara Westermann in May.

In addition to the above, both of our resident advisors have provided follow-up and support on the above activities.

c. ODEF

Four major activities were programmed with ODEF in the eighteen-month work plan through March 2003 in addition to the ongoing support provided by our resident advisors. These are:

i. Assistance in the transformation to a regulated FPVO

CARANA consultant, Mr. William Phelps, provided limited support in this area. Additional support is programmed for the second semester of 2002.

ii. Support in the marketing area

This activity is currently pending, and will be completed by Mr. Luis Ludeñas during the second semester of 2002.

iii. Assistance in the decentralization of the credit functions

This activity was completed in June by CARANA consultant Henry Cardona.

In addition to the above, our resident advisor, Mr. Elvis Alva, has provided follow-up and support on the above activities, and continues to work with the institution on strengthening the overall credit process.

d. Hermandad de Honduras

Three major activities were programmed with FINCA in the eighteen-month work plan through March 2003 in addition to the ongoing support provided by our resident advisors. These are:

i. Assistance in the transformation to a regulated FPVO

This activity is being carried out by Mr. William Phelps. It is an ongoing process and is progressing as scheduled.

ii. Marketing analysis - client loyalty and desertion issues

This assignment was completed in April by CARANA consultant Luis Ludeñas.

iii. Human resources - organizational manual, policies and procedures

This work will be carried out during the second semester of 2002 using resident staff.

In addition to the above, our resident advisor, Mr. Elvis Alva has provided follow-up and support on the above activities, and continues to work with the institution on strengthening the overall credit process.

e. Covelo retail operations

Two major activities were scheduled during in an eighteen-month work plan for Covelo. A third activity in the Human Resources area was added after discussion with Covelo and approval by USAID.

i. Marketing - development of new credit products

This activity was initiated in late July by CARANA consultant Mr. Luis Ludeñas.

ii. Assistance in strengthening the internal audit function

Mr. Mario Miranda will carry out this activity in the second semester of 2002.

- iii. Human Resources - measuring job performance of managerial, operations and administrative staff

Mr. Mario Miranda successfully carried out this activity during the first semester of 2002. This activity was not originally budgeted, but was implemented after discussion with Covelo and approval by USAID. Short-term consulting days that had been budgeted for the marketing task in FINCA were shifted to this assignment.

In addition to the above, our resident advisor, Mr. Elvis Alva has provided follow-up and support on the above activities and continues to work with the institution on strengthening the overall credit process.

f. FAMA

Two activities were programmed for FAMA as part of the eighteen-month work plan.

- i. Assistance in the transformation to a regulated FPVO

This activity is being carried out by Mr. William Phelps. It is an ongoing process and is progressing as scheduled.

- ii. Marketing analysis - client loyalty and desertion issues

This assignment was completed in February by CARANA consultant Henry Cardona.

g. FUNED

Only one activity was programmed for FUNED - A marketing analysis focusing on client loyalty and desertion issues. Mr. Mario Miranda successfully completed this assignment during the first semester of 2002.

- h. Support to the diploma program in microfinance

Additional support to the diploma program being implemented by Covelo and the University of Honduras was not programmed initially due to an oversight on our part. However, during the semester, Mr. Henry Cardona did carry out a course on credit methodology under this program.

**E. FINANCIAL DATA**

## **F. KEY ISSUES FACING THE PROJECT AT THIS TIME**

The project is not facing any major issues or threats at this time. We are pleased to report that we are either achieving or exceeding all of our targets, and our relationship with the project beneficiaries remains very positive. However, as pointed out in our last semester report, there are four major activities currently not addressed under the project that we believe should be addressed by USAID in the future. These were:

- Training and support to the National Banking Commission on the implementation of the new law governing the FPVOs in Honduras;
- The need to develop a better MIS solution for FPVOs in Honduras;
- Additional assistance to Tier III and other FPVOs in Honduras that are not currently beneficiaries under the current project;
- Follow-up assistance to the Covelco reorganization.

While we continue to believe that all four areas are important, two of them (assistance in the implementation of the new law and the need to develop a better MIS solution in Honduras) are critical to the long-term success of the microfinance initiative in Honduras. It is also our understanding that these two issues were also deemed critical by the evaluation team that completed an evaluation of the project in July 2002.

### **III. ANNEXES**

**A. ANNEX A - LIST OF MAJOR DOCUMENTS AND REPORTS FOR THE SEMESTER ENDING JUNE 30, 2002**

Informe De La Consultoría En Mercadeo Realizada En World Relief de Honduras - Febrero 2002

Informe Sobre El Desarrollo Del Modulo III “Metodologías Crediticias” Del Diplomado Sobre Microfinanzas - Febrero 2002

Informe De La Consultoría En Mercadeo Realizada En FUNED Honduras - Febrero 2002

Informe De La Consultoría En Mercadeo Realizada en FAMA Honduras - Marzo 2002

Informe De La Consultoría En Auditoria Realizada En FINCA Honduras - Abril 2002

Informe De La Consultoría En Mercadeo Realizada En Hermandad de Honduras - Abril 2002

Medición De Impacto - Encuesta De Salida Y Análisis De Deserción De Clientes en FINCA - Junio 2002

Informe De La Consultoría Realizada Para Covelo: Evaluación Del Desempeño Del Personal - Junio 2002

Report on Project Indicators as of December 31, 2001 - June 2002

Informe De La Consultoría en Descentralización Realizada en ODEF Honduras - Junio 2002

**B. ANNEX B - SUMMARY OF THE MAJOR ACTIVITIES CARRIED OUT BY THE CHIEF OF PARTY IN THE FIRST SEMESTER OF 2002**

14.01.02	Inf. # 001-02	Request for information on institutional indicators as of December 31, 2001.	COVELO
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A memorandum was sent to the General Management of Covelo requesting this information so that we could comply with our requirements to USAID in this area.

14.01.02	Inf. # 002-02	Request for information on institutional indicators as of December 31, 2001.	WRH
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A memorandum was sent to the General Management of WRH requesting this information so that we could comply with our requirements to USAID in this area.

14.01.02	Inf. # 003-02	Request for information on institutional indicators as of December 31, 2001.	FINCA
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A memorandum was sent to the General Management of FINCA requesting this information so that we could comply with our requirements to USAID in this area.

14.01.02	Inf. # 004-02	Request for information on institutional indicators as of December 31, 2001.	ODEF
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A memorandum was sent to the General Management of ODEF requesting this information so that we could comply with our requirements to USAID in this area.

14.01.02	Inf. # 005-02	Request for information on institutional indicators as of December 31, 2001.	HDH
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A memorandum was sent to the General Management of HDH requesting this information so that we could comply with our requirements to USAID in this area.

15.01.02	Inf. # 006-02	T/A Report on the reorganization process of COVELO	USAID
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Mr. William Phelps undertook finalization and presentation of the report on the reorganization process for Covelo between September and December 2001.

18.01.02	Inf. # 007-02	Activity Report by resident advisor for Covelo's retail operations during the second semester of 2001.	USAID Covelo
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Preparation and submission to USAID and Covelo of the report on the activities undertaken by the resident advisor Mr. Elvis Alva in support of Covelo's retail operations.

22.01.02	Inf. # 010-02	Activity Report by resident advisor for HDH during the second semester of 2001.	USAID HDH Covelo
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Preparation and submission to USAID, Covelo and Hermandad de Honduras of the report on the activities undertaken by the resident advisor Mr. Elvis Alva in support of Hermandad de Honduras

23.01.02	Inf. # 012-02	Activity Report by resident advisor for ODEF during the second semester of 2001.	USAID ODEF Covelo
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Preparation and submission to USAID, Covelo and ODEF of the report on the activities undertaken by the resident advisor Mr. Elvis Alva in support of this institution.

25.01.02	Inf. # 015-02	Activity Report by resident advisor for World Relief during the second semester of 2001.	USAID WRH Covelo
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Preparation and submission to USAID, Covelo and World Relief of Honduras of the report on the activities undertaken by the resident advisor Mr. Elvis Alva in support of this institution.

31.01.02	Inf. # 018-02	Training Report - Measuring the Impact Application of Second Tool.	USAID Covelo
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Preparation and submission to USAID and Covelo of the report on the training event "Evaluation of Impact and Satisfaction of Clients in Institutions and Programs of Micro Financing", and related attachments and materials from the course.

18.02.02	Inf. # 021-02	Progress Report for second semester of 2001 and Work Plan for 2002.	USAID
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Assistance in the preparation and submission to USAID of the Progress Report for the second semester of 2001 and the work plan for the period from January 2002 until the end of the project in March 2003.

26.02.02	Inf. # 025-02	Support to two consultants from IADB who were gathering information on our project.	HOTEL CLARION
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Meeting with two Chilean consultants financed by the Interamerican Development Bank who came to Honduras for one week to review the technical assistance activities carried out in Honduras in support of microfinance and to explore the possibility of duplicating some of the training activities that we had carried out under the project.

01.03.02	Inf. # 026-02	Activity report on restructuring and specialization process for FPVO's.	USAID Covelo
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Preparation of an activity report for USAID and Covelo on the activities carried out during February of 2002 for World Relief, FAMA and FINCA- Honduras assisting them in the restructuring process in order to comply with the new law governing FPVOs in Honduras.

12.03.02	Inf. # 029-02	Report on the participation in the Encuentro de Entidades de Cooperación Plan Puebla-Panamá	USAID
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Preparation and submission to USAID of the report on our participation in the Encuentro de Entidades de Cooperación Plan Puebla-Panamá, event that took place on March 7 and 8 at the CABEI in Tegucigalpa, and which was attended at the request of Mr. Raymond Waldron of USAID.

20.03.02	Inf. # 030-02	Manual for credit evaluation and the new credit evaluation forms.	WRH USAID
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Preparation and submission to World Relief on the delivery of the manual for credit evaluation and the new credit evaluation formats developed and tested by WRH in a pilot program and then approved by its general management. The manuals were to be used in the implementation of the roll out of these revised procedures and formats by WRH.

21.03.02	Inf. # 031-02	Report on the new organizational structure for WRH under the new law governing FPVOs.	WRH
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After review and approval by the management of World Relief, we formally submitted a report on the new organizational structure for WRH under the new law governing FPVOs in Honduras.

27.03.02	Inf. # 032-02	Report on the short-term TA in Marketing for WRH	WRH USAID Covelo
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Preparation and submission of the report on the short term technical assistance provided by Mr. Luis Ludeñas for WRH in marketing during January and February of 2002.

27.03.02	Inf. # 035-02	Report on the short-term TA in Marketing for FUNED	FUNED USAID Covelo
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Preparation and submission of the report on the short term technical assistance provided by Mr. Mario Miranda for FUNED in marketing during January and February of 2002.

02.04.02	Inf. # 038-02	Coordination for TA on incentive program for loan officer productivity.	ODEF
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Participation in the start-up of the assignment to create an incentive program for loan officers that would reinforce ODEF's objectives.

10.04.02	Inf. # 039-02	Activity report on restructuring processes for selected FPVO's.	USAID Covelo
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Preparation of an activity report for USAID and Covelo on the activities carried out during March of 2002 for World Relief, FAMA, Hermandad and FINCA- Honduras assisting them in the restructuring process in order to comply with the new law governing FPVOs in Honduras.

10.04.02	Inf. # 041-02	Transformation and specialization process in FINCA Honduras.	FINCA
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Worked with the General Manager of Finca in clarifying issues raised by members of the board of directors on the transition of FINCA Honduras to a regulated entity under the new law.

11.04.02	Inf. # 042-02	Report on Training Event on the Microfinance Diploma.	USAID
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Preparation and submission of the report on the training event conducted under the Diploma for Microfinance program in March of 2002. Mr. Henry Cardona implemented the three-day training event.

22.04.02	Inf. # 044-02	Report on TA developed in FAMA	FAMA USAID Covelo
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Preparation and submission of the report on of the technical assistance activity carried out by Mr. Henry Cardona for FAMA on the viability of credit operations in potentials markets and in the credit process.

25.04.02	Inf. # 047-02	Work Plan and training at FINCA for the execution of an exit strategy survey.	FINCA
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Assistance to FINCA's management in the design of the exit survey and in training of the interviewers in order to carry out this survey.

10.05.02	Inf. # 050-02	Analysis of the initial results in carrying out the exit survey conducted in FINCA	FINCA
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Assistance to FINCA in reviewing the survey and in correcting some of the problems experienced by the interviewers in conducting test surveys under this program.

15.05.02	Inf. # 051-02	Coordination and programming of technical assistance in WRH	WRH
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Meeting with the management of WRH to develop the SOW for the technical assistance to this institution in the Human Resources area supporting the transition to a fully regulated FPVO under the new law.

16.05.02	Inf. # 052-02	Request for and review of revised financial indicators for the institution as of December 31, 2001.	Covelo WRH FINCA ODEF HDH
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Given problems experienced with the original submission of the financial indicators submitted to CARANA. Additional guidance was provided for the submission of a new set of indicators based on final audited statements for each institution as of December 31, 2001.

20.05.02	Inf. # 057-02	Report on the short-term TA on Marketing for HDH	USAID HDH Covelo
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Preparation and submission of the final report on the technical assistance provided to Hermandad de Honduras in Marketing by Mr. Luis Ludeñas in March and April of 2001.

27.05.02	Inf. # 060-02	Resubmission of the audit and inspection manuals drafted in 2001	CNBS
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Resubmission of the audit and inspection manuals drafted by Mr. Mario Miranda in 2001 and meetings with the new superintendent of the CNBS.

28.05.02	Inf. # 062-02	Report on the incentive system for loan officers	ODEF USAID
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Preparation and submission of the new incentive system for loan officers supporting the objectives of ODEF.

28.05.02	Inf. # 063-02	Report on the incentive system for loan officers	Covelo USAID
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Preparation and submission of the new incentive system for loan officers supporting the objectives of Covelo - revised formula

10.06.02	Inf. # 065-02	Report on the short-term TA on the audit function in FINCA.	FINCA USAID Covelo
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Preparation and submission of the report on strengthening the internal audit function at FINCA to comply with the requirements of the new law governing FPVOs in Honduras. This work was carried out by Mr. Mario Miranda in April - May of 2002.

11.06.02	Inf. # 067-02	Report on Indicators and Benchmarks of the FPVO's to December 2001	USAID
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Assistance in the preparation of the report to USAID on indicators and benchmarks for selected FPVOs as of December 31, 2001.

17.06.02	Inf. # 069-02	Analysis and recommendations on past due loans.	WRH
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An analysis of the behavior of loan delinquency for each one of the credit programs in World Relief over the last four years and for the first four months of the 2002 was prepared.

18.06.02	Inf. # 070-02	Proposal for the new organizational structure of HDH	HDH
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Preparation of the proposal for the new organizational structure, along with job descriptions and performance standards in order to assist HDH in the transformation process to a regulated FPVO in Honduras.

## **C. ANNEX C - EXECUTIVE SUMMARY: TECHNICAL ASSISTANCE TO FINCA IN THE STRENGTHENING OF THE INTERNAL AUDIT FUNCTION**

Consultants: Mario Miranda, José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

The new law governing FPVOs in Honduras will impose new requirements that affect all of the financial NGOs to which CARANA has been providing technical assistance. One of the areas that will be most impacted will be the internal audit function within these financial NGOs given that under the new law, the National Banking and Insurance Commission (CNBS) will require these institutions to implement stringent internal control functions that are consistent with that of a regulated financial institution.

FINCA Honduras already has an internal audit unit that reports directly to the Board of Directives and which receives audit guidelines from the audit administration of FINCA International. This technical assistance activity centered on reviewing the current functions and structure of FINCA's internal audit function, and to the degree to which this unit complies with the new requirements being implemented by the CNBS.

#### **2. Conclusions**

Our review of the current internal audit function demonstrated that this unit has not been carrying out its activities adequately and definitely would not meet the more stringent criteria being implemented by the CNBS, which will become effective in early 2003. The audit unit itself is made up of an internal auditor and four assistants who are assigned to specific branches and operations. The current distribution of the staff among the branches and home office which features the permanent assignment of some audit staff to specific offices does not meet generally accepted audit standards in that a permanent assignment to a branch office can bring about a loss of independence and objectivity. Audit staff should always be rotated among offices and functions to insure that they remain objective and independent.

It was also observed that the internal audit function has not even complied with the requirements established by FINCA International in its audit guidelines. Past audit reports have not adequately measured the risks within the institution, have not focused on problem areas, have failed to uncover significant problem areas, and tend to be very superficial and repetitive. As a result, the audit programs applied in FINCA have not detected important weaknesses of the internal control system, have resulted in financial statements and have not accomplished their overall objective of analyzing and adequately quantifying the risks that the institution faces.

As part of our report, we have included a recommended structure for the internal audit function and have also made recommendations regarding the specific functions that should be implemented by the audit unit in order to comply with the new standards imposed by

the CNBS. One of the areas we focused on was in the planning of the annual functions and of the annual audit program given that the audit unit needs to be much more specific in how it programs its resources in order to better comply with the objective of the audit - something which has not been done in the past. As an annex to our report we have provided a proposed sample work plan along with other recommendations which should contribute in an important way to strengthening this audit function. This work plan should be formally reviewed and adopted by FINCA in the near future.

## **D. ANNEX D - EXECUTIVE SUMMARY: IMPACT ANALYSIS - EXIT SURVEY AND ANALYSIS OF CLIENT DESERTION, FINCA - JUNE 2002**

Consultants: José Luis Lozano and Cara Westermann

### **Executive Summary**

#### **1. Introduction**

At the request of FINCA's general manager, CARANA Corporation agreed to provide technical assistance to this institution in the implementation and analysis of an exit survey of FINCA's clients. Assistance in this area was requested because of the very high desertion rate that FINCA had been experiencing. Client desertion is an area that many FPVOs in Honduras have been facing problems, and one in which CARANA has been providing a great deal of support in the last year.

The exit survey is a valuable tool in better understanding the reasons why clients leave a credit program. By building on the knowledge gained through the survey, CARANA has then been able to make recommendations on how to improve existing programs in order to have a better probability of retaining good existing clients.

#### **2. Methodology**

In a work plan submitted to FINCA's management in April, CARANA consultants were able to describe the objectives of the survey and provided recommendations on the selection criteria for selecting the survey staff, for identifying a representative sample, on how to carry out the survey, how to analyze the data and how to interpret the results.

CARANA staff then worked with FINCA's managers to train the survey staff, who were recruited from the internal audit division within FINCA. Working with this staff, the proposed questionnaire was reviewed and modified, and the actual survey work began in May of 2002. Data was collected over a four-week period and in June the data was tabulated and reviewed for analysis.

Data was collected on 198 participants all ex-clients of FINCA. 91% of the respondents were women. The sample was initially biased towards the identification of individuals who had completed at least six credit cycles within the village banking methodology (30% of the sample base), however, the final survey respondents included only 34 ex-clients that met that criteria (17%). As a result, the sample database was divided into clients with more than three credit cycles and those with three or less.

#### **3. Results**

The analysis showed that 35% of the respondents left because of problems related to the make-up or management of the village bank (problems with other members, rules, meeting times), and that another 35% left for personal reasons that were not related to their business (personal, illness of a family member or self, pregnancy, theft, fire, etc.). 15% of

the respondents left because of a better offer from another village bank or because they did not agree with the policies or procedures of the village bank. The final 15% left because they had problems with their business.

A further breakdown of the results shows the following:

- 15% had a business crisis, or a crisis within the family (death, sickness, marriage, etc.).
- 15% expressed that they did not have the capacity to pay another loan due to problems in their business (low sales, lack of customers, etc.).
- 13% did not want or were not willing to attend the village bank meetings.
- 9% are moving from their area. Of these people a high percentage were individuals who depended on the economic activity of a large business in the area that had either closed or moved.
- 8% did not agree with the frequency of the payment plan.
- 8% were not happy with the leaders of the village bank.
- 8% had to pay another village banking member's debt.

On the positive side, the majority of the respondents recognized that the loans had helped them in their business. The loans also had a positive effect on their personal lives - almost 90% of the former clients expressed that the loans had helped them in personal and family lives which included more and/or better food (35%), more resources for a family member's education (22%), additional clothing (22%), and more or improved items for their houses.

With regards to their loan payments, almost 30% expressed that they had difficulty making their payments and 59% had problems related with their capacity to pay. 10% expressed that the loan amounts were too small.

Almost all those interviewed felt that they benefited from being members of the Village Bank. Some of the benefits included the following:

- New friendships obtained (74%)
- Training and information received (23%)
- Assistance in making their payments (22%)
- Ideas and contacts obtained (16%)
- Gave them an opportunity to develop their leadership skills (13%)

When asked about other aspects of the program that they liked, 37% responded that they were pleased with the treatment given to them by FINCA's personnel, the interaction among the group (24%), the savings that FINCA demanded of them (14%), and the ease of obtaining a loan (13%). When asked what they liked least about the program, half of the respondents said that they did not have negative comments or that they did not wish to respond. Of the other 50%, 25% of them mentioned that they did not like the meetings, 20% did not agree with the payment frequency, 13% objected to the delay in loan disbursements, and 13% objected to having to pay another member's debt.

Finally, most of the former clients were satisfied with FINCA and their credit program. 77% said that they would probably return to the program, and 85% they would recommend it to friends or family.

## **E. ANNEX E - EXECUTIVE SUMMARY: TECHNICAL ASSISTANCE IN MARKETING TO WORLD RELIEF HONDURAS**

Consultants: Luis Ludeñas, Elvis Alva, and José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

In February of 2002, CARANA consultant Luis Ludeñas carried out a four-week technical assistance activity to analyze World Relief of Honduras' (WRH) client desertion problems and to assist in developing and implementing a marketing strategy and program to address client desertion. This consultancy was part of CARANA's ongoing support to WRH, which is aimed at strengthening the institution's overall credit portfolio and improving its financial sustainability.

World Relief operating plan for 2002 establishes as one of its priorities the need to improve the rates of client retention and client desertion. The plan sets a specific goal of reducing the desertion rate by at least 10%. This would translate to the retention of an additional 2000 clients per year and would have an impact of about L 5.6 million on the loan portfolio.

The operating plan stresses that in order to accomplish this goal, the institution will have to begin investing in client analysis in order to take corrective action. This consulting assignment is one of the first steps in helping WRH achieve their goal of reducing the client desertion rate.

#### **2. Analysis of the Information**

With the exception of the results obtained in 2000, over the last ten years, WRH has shown a positive evolution in the growth of the client portfolio. However, it is important to note that the overall growth rate has slowed considerably.

With respect to client desertion:

- An analysis of the available data shows that the client portfolio turned over 1.7 times in 2001. Given the problems with the way client data is tracked and with current MIS, we know that this figure is only an approximation. This points to the need to revise the related procedures so that client information and turnover can be adequately monitored. Further analysis on more accurate data in the future may result in additional conclusions and or contradictions with this earlier assessment.
- The analysis points to specific peaks or seasonality in WRH's desertion, with peaks during March and April, June and July, and October and November. These peaks also coincide with peaks in client demand, although the relationship between the two is not clear.

- The average loan amount among clients during these periods is Lps. 2,800, a figure that is useful in measuring the effects of client desertion on the size of the loan portfolio.

An analysis of the client base (based on a small sample) showed some of the following trends:

- Greater loyalty in the older clients, while new clients tend to be much more mobile;
- Clients that leave the program have almost always paid off their loans;
- Most clients leave on their own accord;
- 92% of clients that have left state that they will return to the program;
- 67% of the clients that have left expressed dissatisfaction with some aspects of the loan product's design;
- A problem with the management and reporting of savings caused widespread problems and a loss of "Trust " in the institution.

### 3. Recommendations

Some of the specific recommendations presented and developed in the report include the following:

- Incentive Campaign for Clients
  - Development of Referral Campaign.
- Program for "Preferred" Clients
  - Development of a direct marketing program aimed at these preferred clients.
  - Creation of the concept of an elite client club or of a preferred client status (or other form of recognition).
- Improved Value Added
  - Implementation of special training programs or training workshops for clients.
- Improved Service and Quality Campaign
  - Development of a program aimed at WRH's personnel aimed at promoting new ideas to improve client loyalty.
  - Development of a program for loan officers that would promote a healthy competition among them.

The consultant also observed that in the past, marketing programs had been developed as isolated programs - almost on an ad-hoc basis - outside of the overall planning process within the institution. This in turn has affected the implementation and results obtained through these programs. The consultant recommended that the institution's marketing plan be developed as part of the overall business plan so that actions in the marketing area would be better integrated within the overall business and not - as is the case now - carried out as independent actions.

For example, a research function within the marketing area should result in a review and possible redesign of loan products and/or procedures. This in turn should result in the design of new marketing campaigns that all personnel are aware of and play a part in. This sort of integration of activities should greatly improve the ability of the institution to not only improve desertion ratios, but to improve the overall quality and levels of the loan portfolio.

## **F. ANNEX F - EXECUTIVE SUMMARY: MEASURING JOB PERFORMANCE AT COVELO**

Consultants: Mario Miranda, Elvis Alva, José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

In May of 2002, CARANA Consultant Mario Miranda carried out a four-week assignment in Covelo designed to strengthen the human resources area within this institution. Specifically, the consultant designed a program and developed an implementation manual for the evaluation of the job performance of managerial, administrative and operations personnel within the retail arm of the foundation.

Covelo's management requested this work recognizing that in order to maintain its leadership in a market which is becoming more competitive every day it must change the way it measures employee performance, focusing on overall employee contribution to the Foundation's objectives.

This assignment is part of an overall effort on CARANA's part to assist the Foundation in the reorganization process, which was initiated in 2001, and to comply with the requirements of the new law governing FPVOs in Honduras.

#### **2. Conclusions**

The consultant carried out an extensive diagnostic of the existing human resources function within Covelo specifically focusing on the way job performance was being measured. This early analysis revealed that Covelo had invested in the development of personnel administration manuals, had a continuous evaluation in place, and had also developed a strong training and motivational program that demonstrated the concern on behalf of management in this area.

However, during the course of the consultancy, specific areas for improvement were identified, particularly in the areas of recruitment, employee selection, orientation and training and compensation packages. All of these areas impact on the personnel evaluation process developed in the body of this report.

The personnel evaluation system proposed in this report includes a procedures manual with its respective guidance. It is designed to:

- Provide a job description for each position that clearly states the employees' responsibilities;
- Develop performance indicators and action plans that help employees meet or surpass their objectives;

- Use positive reinforcement as the primary tool for motivating employees;
- Advise employees when their work performance diminishes;
- Develop the framework in which to formally discuss job performance.

The proposed system also provides additional guidance on the implementation of the overall human resources function and also provides guidelines for the responsibilities and functions of the evaluation committee that oversees these functions.

## **G. ANNEX G - EXECUTIVE SUMMARY: TECHNICAL ASSISTANCE IN MARKETING FOR HERMANDAD DE HONDURAS**

Consultants: Luis Ludeñas, José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

In April 2002, CARANA Consultant, Luis Ludeñas, carried out a three-week technical assistance activity with Hermandad de Honduras (HDH) to support this institution's marketing efforts. The consultant's tasks included an analysis of the first impact survey tool - client desertion carried out by HDH, which had been conducted on 134 former clients. The consultant reviewed these survey results, verified the findings in the field, and then worked with management to design new products and programs to address the client desertion - client loyalty issue.

#### **2. Analysis of the Current Client Base**

An analysis of the data revealed the following:

- In 2001, Hermandad was able to turn around a decline in its client base, achieving a growth rate in total clients in that year of 55% over the previous year. The individual loan program grew at the fastest rate and represents the largest loan program in their portfolio.
- During the year, Hermandad added 1059 new clients, which meant that on average each branch was able to capture 17 new clients per month. This translates into 7 new clients per month per loan officer.
- The desertion rate in 2001 dropped to 17% of the client base compared to a desertion rate of 33% in the period year.

#### **3. Exit Survey on Former Clients**

The analysis of the exit survey results revealed the following:

- Of the clients surveyed, 36% left because of a disagreement with HDH's credit policies. 27% of the total interviewed were solidarity clients that left because of problems with the solidarity group. The balance left for a variety of personal or non-program related reasons.
- Those former clients that cited problems with HDH's credit policies almost all cited problems with the loan product itself - interest rates, time frame, frequency of payment, or small size of the loan.

- An analysis of the last loan made to these clients showed that the vast majority of the loans were not used for the client's microbusiness itself, but rather used for other things.
- When asked if they would recommend the program to family and friends, 77% responded “yes”.
- Among the positive aspects cited by former clients were: ease of getting a loan, friendliness of staff, speed at which they were able to get a loan, and agreement with the payment plan.

A small market survey carried out by the consultant in Santa Rosa also revealed some interesting results.

- Only 18% of the businesses surveyed had loans with Hermandad, 24% had loans with other institutions, and 58% did not have loans at all.
- Of the 58% that are not receiving loans from any institution, 41% (24% of the total number of businesses surveyed) have interest in requesting loans, and 59% (34% of the total surveyed) doesn't have interest in obtaining loans.
- Of those that had loans with other institutions, 67% (16% of the total) had loans with Banco de Occidente (almost an equivalent market share as Hermandad).

#### 4. Conclusions

- Hermandad needs to improve its market research in order to gather more information on its competitors, monitor market share, and improve its loan products. Specific recommendations have been made in this area, which include greater market segmentation in the analysis (by client type, loan type, and location).
- Hermandad prices both of its principal loan products the same (solidarity and individual loans), although loan size and costs are very different. Hermandad needs to better understand the cost of each type of loan and possibly adjust its pricing as a result.
- The average of 7 new clients per month for HDH's loan officers is very low. There are several factors affecting this, however this lack of productivity, particularly when the market survey undertaken in Santa Rosa shows that 24% of the businesses surveyed were interested in a loan, demonstrates that HDH should be able to improve loan officer productivity and needs to work towards that end. One suggestion was to alter the incentive system for loan officers so that there is a greater weight placed on the capturing of new clients.

Specific recommendation included a better management in the utilization of loan officers in specific geographic areas (specific forms for improving loan officer utilization and the monitoring of these were supplied).

- While desertion rates have improved, Hermandad should consider a program(s) to improve client loyalty. The body of the report contains specific recommendations in this area.

## **H. ANNEX H - EXECUTIVE SUMMARY: TECHNICAL ASSISTANCE IN THE DECENTRALIZATION OF ODEF HONDURAS**

Consultants: Henry Cardona, José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

During the months of June and July 2002, CARANA consultant, Henry Cardona completed a four-week consultancy aimed at supporting ODEF's (Organization de Desarrollo Empresarial Femenino) efforts in decentralizing its credit operations. The decentralization issue has been a major topic of interest for the CARANA team, given that this has always been viewed as one of the most important steps in streamlining and improving the credit procedures of the financial NGOs in Honduras. The CARANA team also views the decentralization process as an important step in the transition of a financial NGO to a regulated FPVO under the new law governing FPVOs in Honduras.

The terms of reference for this assignment called for the consultant to review a proposed operating manual prepared by ODEF staff for the proposed decentralization of the credit operations and to review of actual and proposed activities at the main office and in three branch offices. The diagnostic review took into account the credit procedures, finance activities, logistics, technical support, internal controls and human resources as they relate to the decentralization process. Upon initiating the assignment, however, ODEF's management requested that the consultant not work on the decentralization of the check issuing process (loan disbursement) as they did not feel comfortable with that at this time. ODEF's management expressed that they would incorporate that activity into a later step once they were satisfied that this first phase of the decentralization process had been implemented successfully.

#### **2. Recommendations**

After reviewing the operations of several branches and carrying out an analysis of the support functions carried out in the home office, the consultant developed various proposals for the decentralization pilot to be carried out with his assistance. These were presented to management along with a thorough analysis, and management in turn approved implementation in a pilot program. The approved programs to be implemented in the pilot program were: a) the receipt of loan payments by the client at the branch level (registering the payment receipt); and b) processing of loan applications at the branch level.

The decentralization of these activities was designed to allow for faster and better attention to the client, and for a more accurate and streamlined procedure at both the branch level and the home office. Paperwork would be reduced substantially, and more importantly, errors that had resulted in the past from shuffling papers back and forth between the branches and the home office would be eliminated. Finally, information would be entered into the accounting system faster and more accurately than before.

Specifically, the process of accepting and posting payment coupons at the branch level is expected to have the following benefits at the branch and central offices:

- It will allow ODEF to update its loan database every two days as compared to only once or twice a week with information that was already several days late.
- It will avoid the loss of payment coupons sent by the agencies to the central office, thus reducing the need to go to the client to request their copy to update their own account balance.
- It will allow ODEF to generate weekly portfolio reports by the loan officer as compared to monthly under the present system. This allows the loan officer and branch managers to have more accurate and timely understanding of the state of the loan portfolio (loans in arrears by loan officer, etc.), which in turn allows for a faster response and improved controls. It will also allow for better overall decision-making and better response to client inquiries.
- Finally, it will decongest the systems department by reducing the amount of work currently done centrally (no more posting of payment coupons sent in from the branches).

The processing of loan applications at the branch level is expected to result in the following benefits:

- It will reduce the time it takes to analyze and disburse a loan, thus offering clients better and more accurate service.
- Loan officers and branch managers will assume a greater responsibility for the loans that they process and approve.
- It will decongest the systems area in the home office through the elimination of data entry at that level and reduce errors as a result of moving paperwork from the branches to the main office for data entry.

The consultant finished his assignment in early July, however, under an agreement with the Foundation of the Royal Spanish Government ( CODESPA), the consultant stayed on for an additional two months to oversee the implementation of his recommendations in the proposed pilot program.

## **I. ANNEX I - EXECUTIVE SUMMARY: TECHNICAL ASSISTANCE IN MARKETING FOR FAMA IN HONDURAS**

Consultants: Henry Cardona, José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

In February and March of this year, CARANA consultant Mr. Henry Cardona carried out a four-week assignment with the Asociación Familia y Medio Ambiente (FAMA). This assignment had two objectives: a) to work with management to improve client loyalty and reduce the desertion rate at the institution, and b) to analyze the viability of the branch office in Danlí. A summary of the recommendations contained in the report include:

#### **2. Improving Client Loyalty**

Given that FAMA does not have adequate information on the reasons behind its high client desertion rate, the bulk of the consultants efforts in this area focused on making specific recommendations on the collection and analysis of client information in order to improve the decision making process in the future. The consultant did carry out his own informal survey, which he used to gather information and make additional recommendations to management. Specific recommendations in this area included:

- Carrying out an exit survey on clients that voluntarily leave the institution. A survey model was proposed. It was proposed that the survey be implemented regularly in order to monitor ex-client sentiment and take corrective action as appropriate.
- Encouraging management to implement focus groups with the boards and clients of the different village banks within its system.
- Improve the service in the Danlí branch office in the following areas:
  - Program loan disbursements so that the time period from the disbursement to the first payment is equal to the other payment periods. Because the first payment period is currently shorter, it results in a higher effective interest rate for the borrower.
  - Waive a late payment charge when a group makes a scheduled payment on a Saturday. Currently, FAMA posts the payment on the next working day and it is registered by the system as a late payment when it really is not.
  - Implement a system of incentives for reliable clients:
    - > Lower the interest rate after a certain number of loan cycles for returning clients;
    - > Return a percentage of the interests paid during the cycle;
    - > Award plaques or diplomas to clients that have over two years of on time payments.

- Take into consideration the length of time a good client has been with the institution when he or she decides to temporarily retire from a village bank with intent to return in the future.
- Provide support in the creation and development of the village banks through loan officer visits. On several occasions the village bank members informed our consultant of the lack of support by the loan officers at this critical stage.
- Clearly explain to clients how their funds are managed, regularly distribute the earnings of the group, insure that the boards of each village bank make periodic reports to the members on their funds, distribute savings and earnings each time one of the members retires, insure that the regulations are followed, etc.
- Carry out post-loan visits with greater interest, following up on improvements of the business or family situation, and keeping in mind the development of a long-term relationship with each client.
- Create a mechanism to receive suggestions and complaints from clients and promote its use through meetings with the village banks and clients. This must be carried out in conjunction with a pledge on the part of FAMA's managers to act on these suggestions and complaints.
- Carry out annual or biannual personnel training activities on client service. Employees should be constantly reminded of the increasing competition in the marketplace and of the new legal environment, which will result in regulation and supervision, by the banking superintendency.

### 3. Viability of the Danlí's Office

The review of the Danlí office demonstrated that the problems facing that office were not market related, but rather are due to poor support of the office by FAMA, and the problems associated with poor service, repeated errors - all of which have led to a high level of client mistrust and suspicion.

As a result, the consultant made the following recommendations:

- The Board of Directors of FAMA and management must make a decision on whether or not to support the operations of the Danlí branch office in the future.
- Assuming that the decision is positive, a development plan for the office must be developed which establishes resources, commitments, expectations and specific actions to be taken within an established timeframe. Specific issues that must be addressed include improvements to the physical infrastructure, a training program and an incentive program for staff at the office.

- Meet with the personnel at the Danli office to clarify doubts, generate trust, improve communication and send a strong positive message regarding the decision to support and develop the office.
- Implement an in-depth training plan, follow-up and support program for the branch's employees to assure that FAMA's policies, norms and procedures are applied in this office (particularly in the formation of village banks and in credit analysis).
- Modify the incentive system of FAMA so that new employees (mostly the ones in Danli) can partially achieve some of them as they approach their goals.
- As a measure to improve efficiency and client management, FAMA should train all loan officers on credit methodology (village banking and individual credit). This measure would avoid the placement of two loan officers in the same area, and would allow the same loan officer to work with a client that is moving from a village bank to an individual banking relationship.
- The Board of Directives should make a decision regarding the loan portfolio that was restructured, and which is still experiencing high default rates.

## **J. ANNEX J - EXECUTIVE SUMMARY: TECHNICAL ASSISTANCE IN MARKETING FOR FUNED IN HONDURAS**

Consultants: Mario Miranda, José Luis Lozano

### **Executive Summary**

#### **1. Introduction**

In February of 2002, CARANA consultant Mario Miranda carried out a four-week technical assistance assignment with The Fundación Para el Desarrollo de Honduras (FUNED). The consultant carried out an in depth evaluation of FUNED's credit activities using as an initial base the work already completed by CARANA's chief of party on this project, José Luis Lozano. The evaluation focused on issues affecting the growth and quality of FUNED's loan portfolio with an emphasis on client desertion, a problem that had already been identified in the earlier work carried out by Mr. Lozano.

Traditionally, FUNED was almost totally oriented to rural areas of the country, and in 1998 almost 90% of its loans were in these areas. However, in recent years there has been a shift to urban lending given some of the problems faced in rural areas, and by 2001, only 20% of its loans were in rural areas. Furthermore, although the institution has been growing in rural areas, overall growth in 2001 was negligible given the large write offs taken in that year in rural loans.

#### **2. Analysis and Recommendations**

The radical shift in the market from rural to urban has contributed to a series of problems to FUNED which appear to be based to a large degree in a lack of understanding of the market place in which it operates, as well as minimal information on its competitors and clients. This shift into new markets has resulted in poor portfolio performance (evidenced by the very high level of write-offs in 2001), inadequate loan products and poor client service, which in turn leads to extremely high desertion rates (20% desertion rate in the last six months of 2001).

An analysis of a survey of former clients that had been carried out by FAMA

- Desertion rates are high among clients that have completed a second loan cycle. The loss of a client at this point is costly to any institution given the investment made in capturing and analyzing the client during the first two loan cycles.
- 50% of the former clients left voluntarily, implying a high level of dissatisfaction with the program and its policies. Reasons for leaving included problems in the repayment of the loan (25% of respondents) and problems with the formation of the village bank or solidarity group (19%).

- 87% of the respondents did claim that in spite of problems they might have had, they would still rate their participation in the FAMA credit programs as having been positive.
- When asked how the program could be improved, 75% of the respondents felt that the credit methodology (specifically the terms of the loan) should be reviewed. A majority of the respondents also said they would return to the program in the future if some of the aspects of the program were changed.

As a result of the analysis, the consultant made some general recommendations regarding the overall credit program, as well as some specific recommendations regarding the high desertion rate faced by FAMA. General recommendations included:

- Management should review loan policies and procedures with an eye to improving client service and responsiveness.
- Management should review their credit analysis in order to better measure a client's ability to pay, the analysis of guarantees offered by clients, and loan monitoring and follow-up by loan officers.
- Management should also consider a review of their overall Mission, strategy and loan products as a result of the changes in their target market (shift to urban lending) focusing on a review of conditions required to participate in FAMA's loan programs, training of staff, improved market analysis and better communication with clients.

Specific recommendations to reduce the desertion rate included:

- Implementation of a program called "FUNED Rewards your Recommendation". The program is designed to make clients feel that they are a part of the institution and that they can make suggestions and recommendations to improve their institution - and that management will act on these recommendations if merited.
- A strong marketing effort in key commercial zones with a high concentration of target micro businesses. The objective of this effort would be to increase FAMA's market share in these key areas, which could also be served at a lower cost than other less concentrated zones.
- Implementation of a new credit product targeted at preferred clients to make them feel that they are part of a preferential group, and which rewards them for being longer-term clients of the bank.
- Implementation of a "Quality and Efficiency Award" for employees with an objective towards improving the quality of service to clients.
- Implementation of simple training events for long-term clients in an effort to increase their satisfaction with the FAMA credit programs and promote loyalty towards the institution.